VZCZCXRO5810
RR RUEHCHI RUEHDT RUEHHM RUEHNH
DE RUEHGP #0947/01 2490202
ZNR UUUUU ZZH
R 050202Z SEP 08
FM AMEMBASSY SINGAPORE
TO RUEHC/SECSTATE WASHDC 5708
INFO RUCPDOC/USDOC WASHDC
RUCNASE/ASEAN MEMBER COLLECTIVE
RUEHKO/AMEMBASSY TOKYO 5929
RUEHBJ/AMEMBASSY BEIJING 2839
RUEATRS/DEPT OF TREASURY WASHDC

UNCLAS SECTION 01 OF 03 SINGAPORE 000947

SENSITIVE

SIPDIS

STATE FOR EEB/OIA
STATE PASS TREASURY FOR MNUGENT, MPISA
BEIJING FOR DLOEVINGER
TOKYO FOR RKAPROTH

E.O. 12958: N/A
TAGS: ECIN ECON EFIN PGOV PREL SN
SUBJECT: BACKGROUNDER ON THE CHIANG MAI INITIATIVE

REF: SINGAPORE 143

¶1. (SBU) Summary: In Vietnam's recent balance of payments episode, analysts in Singapore and around the region tried to draw comfort from potential loans from one of Asia's premier post-Asian financial crisis programs: the Chiang Mai Initiative (CMI). However, analyst confusion over how the CMI would work --- and how much it could help a country in trouble --- highlighted the need for more transparency for the initiative to prevent market volatility and moral hazard. The CMI started as a network of bilateral swaps launched by the ASEAN Plus Three Finance Ministers (the 10 member of ASEAN plus China, Korea and Japan). Its purpose was to address short-term liquidity problems within the region by providing quick disbursement of 20 percent of the available swap lines while the remaining 80 percent of the funds would supplement an IMF program. While the CMI has grown and recently evolved from a bilateral swap arrangement (BSA) into multilateral framework, there is still much uncertainty in the market and among policy makers about its structure. Key questions include: the dollar amounts available, activation methods, repayment terms, modes of surveillance and whether the 20/80 IMF link will be maintained. End Summary.

Looking for loans in all the wrong places

¶2. (SBU) In April/May 2008, when there was a fear that Vietnam was facing a balance of payment crisis, the analyst community in Singapore and around the region tried to estimate the potential foreign exchange resources the country had at its disposal to avoid currency devaluation and continue making international payments. Analysts turned to the CMI, a regional initiative created after the Asian financial crisis to help disburse money quickly to Asian countries in need and to supplement the resources available under the usual IMF economic adjustment programs.

¶3. (SBU) Analysts produced vastly different estimates of what the CMI could offer to help Vietnam. The estimates ranged from $2 billion (JP Morgan) to $50 billion (Morgan Stanley), all of which were off the mark, as Vietnam only had access for a few hundred million dollars from an ASEAN arrangement (see below) and nothing from the CMI. Singapore-based analysts made frantic inquiries to Post about the terms of this program. The lack of transparency is a worry as it provides a false sense of security to the markets and may contribute to reckless behavior, moral hazard, or delay of needed economic adjustment. Reactions could be volatile when the markets realize that the coverage afforded by the CMI is less than

what the market has estimated or based on different terms. This episode reinforces the need for more clarity and transparency on the CMI.

Swaps expand from ASEAN to ASEAN Plus Three

¶4. (U) Swap arrangements in Asia have a long history: the original five ASEAN members (Thailand, Indonesia, Malaysia, Singapore and Philippines) started their own ASEAN Swap Arrangement (ASA) in 1977. Under the ASA, members were allowed to exchange their local currencies for U.S. dollars on a short-term basis to alleviate "temporary international liquidity problems." ASA was eventually extended to the newer members of ASEAN and was enlarged from $100 million to $1 billion in 2000, and to $2 billion in 2005. Under the ASA, ASEAN contributors can withdraw support up to two times the amount they contributed to the program.

¶5. (U) In May 2000, the ASEAN Plus Three Finance Ministers announced the establishment of the CMI, a network of bilateral swap arrangements (BSA) among ASEAN countries and their three dialogue partners, China, Japan and South Korea. The goal of the CMI was also to supplement the existing international financial arrangements (such as the IMF and the ASA) with a regional swap arrangement that brought in northern Asian countries with larger foreign exchange reserves than their ASEAN neighbors.

¶6. (SBU) Theoretically, the CMI provides for 33 bilateral currency swap agreements to be negotiated, namely 30 BSA between each of the 10 members of ASEAN and China, Japan and

South Korea respectively, and three arrangements among China, Japan and South Korea themselves. However, the actual number of swap lines negotiated among the ASEAN Plus Three so far is 16 and these were concluded among eight countries, namely China, Indonesia, Japan, Malaysia, Philippines, Singapore, South Korea and Thailand. Ten of the agreements are two-way (i.e. they commit to help each other) and six are only one-way (i.e. Japan, China or Korea commit to help the other country, which is under no obligation to return the favor.) The overall size of these 16 BSAs inches up every year, reaching $83 billion as of May 2008. (see table 1.) One Singaporean official admitted that there was much pressure to demonstrate the "political momentum" of the CMI by increasing the size of the bilateral swaps at each annual ASEAN Plus Three Finance Ministers meeting, even if just a token increase.

¶7. (SBU) However, as highlighted in the Vietnam case, not all countries have been able to participate. To date, only the more developed members of ASEAN have completed any BSAs. With the exception of Brunei, the late-comers to ASEAN, namely Cambodia, Laos, Burma and Vietnam, are not a party to any BSA with China, Japan or South Korea. According to a report by the Institute of International Economics, this could be because the poorer members of ASEAN, with less-developed financial institutions, are better served by concessionary foreign aid than BSA. (Note: as Singaporean monetary authorities have pointed out, the lack of a CMI-sanctioned swap deal would not prevent an Asian country from helping out its neighbor in times of need. Many analysts, for example, speculated that Singapore or China would lend to the Vietnamese. Market participants and government officials believed that Vietnamese officials made trips to Beijing, Tokyo and Seoul in search of such assurances, despite their lack of any BSA under CMI.)

Table 1. BSAs under the CMI as of May 2008

Agreements	Amount ($ billions)	Agreements	Amount ($ billions)
¶1. Japan-China	3	9. Japan-Korea	13
China-Japan	3	Korea-Japan	8

¶2. Japan-Indonesia	6	10. Japan-Malaysia	1
¶3. Japan-Philippines	6	11. Japan-Singapore	3
Philippines-Japan	0.5	Singapore-Japan	1
¶4. Japan-Thailand	6	12. China-Korea	4
Thailand-Japan	3	Korea-China	4
¶5. China-Indonesia	4	13. China-Malaysia	1.5
¶6. China-Philippines	2	14. China-Thailand	2
¶7. Korea-Indonesia	2	15. Korea-Malaysia	1.5
Indonesia-Korea	2	Malaysia-Korea	1.5
¶8. Korea-Philippines	1.5	16. Korea-Thailand	1
Philippines-Korea	1.5	Thailand-Korea	1
Total BSAs: 16 (10 two-way, 6 one-way)		Total value	83

Source: Ministry of Finance, Japan

From Bilateralism to Multilateralism

¶8. (U) In May 2008, the ASEAN Plus Three Finance Ministers agreed to work toward replacing the CMI's bilateral swap network with a multilateral framework known as the CMI Multilateralization (CMIM). Under the CMIM, central banks would designate a certain amount of their own foreign exchange holdings to be included in a "multilateral" fund. While these funds would remain at the national central banks, access to the CMIM would be "governed by a single contractual agreement" in which any country in the framework could draw upon these funds to cope with short-term liquidity difficulties. Unlike the bilateral swap arrangements with the "Plus Three" countries of China, Japan and South Korea, the poorer members of ASEAN will also be covered by this new facility.

¶9. (SBU) After much lobbying from their southeastern neighbors, the "Plus Three" countries of China, Japan and South Korea agreed to contribute disproportionately to the CMIM, providing 80 percent of the funds for the multilateral facility, which will initially total at least $80 billion. The remaining 20 percent will be provided by the ASEAN countries. Senior regional officials have remarked on the keenness among the Chinese and Malaysians to make the fund large Q and easy to access Q in order to avoid any dependence on non-Asian funds, especially the IMF. Some regional officials, however, argued that an excessively large fund would create moral hazard.

¶10. (SBU) Further work on the CMIM remains to be done before it can become operational. The ASEAN Plus Three countries have yet to come out with concrete conditions for drawing on the reserve pool, managing the funds (which will remain at individual central banks), or repaying the funds. Most importantly, CMIM needs to develop a mode for economic surveillance of the participants, which will be vital to avoid moral hazard and economic instability. Regional officials have long recognized the shortfalls in ASEAN's regional surveillance efforts given its non-confrontational style and reluctance to criticize their neighbors (reftel). One senior regional official said that a core group of countries (including Japan, Indonesia, Singapore and Vietnam) expressed concern that the CMIM will "lose credibility" without a strong surveillance program, and seem to have effectively put the breaks on the roll-out of the CMIM until such issues can be resolved.

Will the "IMF link" remain?

¶11. (U) The CMI was a response to the IMF actions and the nature of conditionality attached to aid during the Asian financial crisis. Nevertheless, the IMF remained an integral part of the CMI through the provision referred to as the "IMF link." Disbursement of the bulk (80 percent) of the CMI swap lines is dependent on the requesting country participating in an IMF program. Member countries without an IMF agreement are currently allowed to borrow only 20 percent of the total funds they are entitled to withdraw.

¶12. (U) Under the CMIM, the IMF link is less clear. No specific mention of the IMF conditionality was made in the 11th ASEAN Plus Three Finance Ministers Meeting statement. Instead, the ASEAN Plus Three countries strove to strengthen the Economic Review and Policy Dialogue (ERPD) and to fully integrate ERPD with the proposed swap facility. Thus, the ability to link fund disbursement to conditions established outside of the IMF framework will depend on the ability of the ASEAN Plus Three members to create an effective monitoring and surveillance system.

Comment: Concerns about the CMI remain

¶13. (U) In what one senior regional official recently commended as a major U.S. policy shift, then-Treasury Under Secretary for International Affairs Timothy Adams spoke in favor of regional financial initiatives that promote financial sector reform and stability. However, he also argued that "too little is known by the markets or by borrowers about amounts available absent IMF adjustment programs, and the conditions, if any, CMI creditors would impose. More clarity on these issues would aid an assessment of the CMI's compatibility with the international system." (see June 2005 speech at the World Economic Forum in Tokyo: http://www.treas.gov/press/releases/js4323.ht m). Further clarification on the CMI/CMIM is needed for it to play a stabilizing role. Hopefully, until these items are settled, no country will need to actually call the CMI members' bluff.

HERBOLD